

Committee on Ways and Means

H.R. 3768, Katrina Emergency Tax Relief Act of 2005 *House Amendment to Senate Amendment*

RELIEF FOR INDIVIDUALS AFFECTED BY HURRICANE KATRINA

- **Holds families harmless against the loss of tax benefits due to temporary relocations.** Damage caused by the hurricane has displaced hundreds of thousands of individuals, who are temporarily living with family, friends or good Samaritans. Under current law, a prolonged change in their living situation could affect their eligibility for various tax benefits. The proposal allows individuals the option of using their 2004 income to calculate the child credit and the Earned Income Credit on their 2005 tax returns. This special rule applies to individuals who were displaced from their principal residence by reason of Hurricane Katrina. The proposal also grants the U.S. Treasury Department the authority to ensure that taxpayers do not lose tax benefits or experience a change in filing status in 2005 and 2006 due to temporary relocations.
- **Ensures that families are not taxed on forgiven debt.** Under current law, amounts realized from the discharge of indebtedness are generally treated as taxable income to the individual. The proposal ensures that individuals affected by the hurricane are not taxed on personal debt relief related to the hurricane, such as the cancellation of a mortgage, provided before 2007.
- **Provides tax relief for housing assistance to dislocated persons.** The proposal creates a special tax deduction for individuals who provide rent-free housing to dislocated persons for at least 60 days. The deduction is \$500 for each dislocated person housed in the individual's principal residence (up to a maximum of \$2,000). The deduction can be claimed in either 2005 or 2006, but cannot be claimed in both years with respect to the same person.
- **Allows full deductibility of personal casualty losses.** Under current law, individuals who itemize their deductions may deduct personal casualty losses to the extent they exceed 10 percent of adjusted gross income and a \$100 floor. The proposal waives the 10-percent and \$100 floors, thus allowing individuals to fully deduct their losses.
- **Waives 10-percent tax on early distributions from IRAs and pensions for individuals affected by the hurricane.** In general, distributions from IRAs and pensions are subject to a 10-percent penalty if they are made before a certain age. The penalty is intended to discourage individuals from withdrawing funds that are needed for retirement. To ease the financial burden faced by many families in the disaster area, the proposal allows eligible individuals to withdraw a maximum of \$100,000 from their IRAs and pensions without paying the 10-percent penalty. Individuals eligible for the waiver may pay income tax on the distribution over three years. Income tax is not due if the distribution is repaid to the account within three years. The proposal also increases the limit on loans from pension plans from \$50,000 to \$100,000.

- **Extends the Work Opportunity Tax Credit.** Under current law, employers are allowed to claim the Work Opportunity Tax Credit (WOTC) if they hire individuals from certain target groups who are considered to face barriers to employment. The credit generally equals 40 percent of the first \$6,000 of wages paid to the employee in the first year (i.e., the maximum credit is \$2,400). The proposal temporarily creates a new target group under the WOTC, called Hurricane Katrina employees. The target group is comprised of individuals who, prior to the hurricane, lived in an area that is now eligible for individual and public assistance under the Stafford Act.
 - Employers located in an area that is eligible for such assistance may claim the WOTC with respect to Hurricane Katrina employees hired over the next two years.
 - Employers located outside of this area may claim the WOTC with respect to Hurricane Katrina employees hired through the end of the 2005 calendar year.
- **Provides an Employee Retention Tax Credit.** Small employers located in a disaster area that is eligible for individual and public assistance under the Stafford Act may claim a tax credit through the end of the 2005 calendar year if they retain an eligible employee on their payroll. The tax credit equals 40 percent of the first \$6,000 of wages paid to the employee between August 28, 2005 and January 1, 2006. The credit is available to small employers (i.e., an average of 200 or fewer employees in the taxable year) whose business is inoperable as a result of damage sustained by Hurricane Katrina. The credit is not affected if the employee reports to work at another location while the business is inoperable.
- **Provides a longer period of time to replace damaged property without incurring tax.** Under current law, insurance proceeds are not taxable if they are invested in replacement property within two years (with respect to damaged business property) or four years (with respect to damaged principal residences in Presidentially-declared disaster areas). The proposal increases the reinvestment period to five years as long as the replacement property is located within the disaster area.
- **Expands the availability of below-market mortgages in the disaster areas.** Under current law, state and local governments may issue mortgage revenue bonds (MRBs) to finance low-interest rate mortgages for first-time homebuyers who meet certain income and purchase price limits. The proposal waives the first-time homebuyer requirement so that individuals whose homes were rendered uninhabitable by Hurricane Katrina can qualify for these low-interest rate mortgages through 2007. In addition, the proposal provides that up to \$150,000 of the loan proceeds may be used to repair damaged homes. To be eligible, the new home must be located in the declared disaster area.

EXTENSION OF DEADLINES

- **Extends deadlines for paying excise and employment taxes.** The IRS has taken administrative action to extend the deadlines for filing tax returns and making tax payments until January 3, 2006. These extensions apply to income, estate and gift taxes for those affected by Hurricane Katrina. The proposal extends the deadline until February 28, 2006. The proposal also applies this extension to excise taxes and employment taxes, in addition to income, estate and gift taxes.

INCENTIVES FOR CHARITABLE DONATIONS

- **Encourages cash donations by individuals.** Under current law, individuals may deduct charitable donations up to 50 percent of their adjusted gross income. Deductions for charitable donations are further limited by the phase-out of itemized deductions. Under the proposal, cash donations to charities are exempt from the 50-percent income limitation and the phase-out of itemized deductions if the donations are made before January 2006.
- **Encourages cash donations by corporations.** Under current law, corporations may deduct charitable donations up to 10 percent of their taxable income. The proposal waives the 10-percent income limitation for cash donations related to Hurricane Katrina if the donations are made before January 2006.
- **Modifies tax treatment when using a personal vehicle for charitable work.** Under current law, individuals may claim a tax deduction for the costs associated with using a personal vehicle for charitable work. The deduction is calculated by using a mileage reimbursement rate of 14 cents-per-mile. The reimbursement rate for business use is set periodically through IRS guidance and currently stands at 48.5 cents-per-mile. The proposal sets the mileage reimbursement rate for charitable contributions at 70 percent of the standard business mileage rate. If the individual is a volunteer and is reimbursed for the use of the personal vehicle, the proposal ensures that the individual does not have to pay income tax on the reimbursement. Both provisions are effective through December 31, 2006.
- **Encourages charitable donations of food inventory.** Under current law, C-corporations may deduct the cost of food inventory donations. The value of the deduction is equal to the lesser of two times the basis or basis plus one-half of the added value. The proposal extends the current-law deduction for food donations to S-corporations, partnerships and sole proprietors through the end of the 2005 calendar year.
- **Encourages donations of educational books to public schools.** The proposal allows a charitable deduction through the end of the 2005 calendar year for donations of educational books to public schools. The value of the deduction is equal to the lesser of two times the basis or basis plus one-half of the added value.

BACKGROUND

- On September 15, 2005, the House passed H.R. 3768, the *Katrina Emergency Tax Relief Act of 2005*, by voice vote.
- The Senate passed S. 1696, the *Hurricane Katrina Tax Relief Act of 2005*, by Unanimous Consent on the same day. Later in the day, the Senate called up H.R. 3768 and amended it with a modified version of S. 1696. The modifications helped bring the House and Senate versions of the bill into conformity. The Senate amendment passed by UC.
- The House is further amending H.R. 3768 to resolve the remaining differences between the House and Senate bills. The House Amendment makes the following changes to H.R. 3768, as passed by the House on September 15:
 1. Adopts the Senate provision to extend excise and employment tax deadlines through February 28, 2006.
 2. Adopts the Senate provision that ensures volunteers will not be taxed if they are reimbursed for use of personal vehicle for charitable work.
 3. Extends the enhanced charitable deduction for individual cash donations so that it applies to cash donations made to all charities, not just charities related to Hurricane Katrina.
 4. Adopts the Senate provision that allows up to \$150,000 of mortgage revenue bond proceeds to be used to repair homes damaged by Hurricane Katrina.
 5. Expands the WOTC credit so that employers outside of the designated disaster area may claim the credit for eligible individuals hired through the end of 2005.
 6. Adopts a modified version of the Senate provision for an employee retention tax credit. The modified provision applies to small employers with respect to individuals whose primary place of employment prior to the hurricane was in the disaster area.
 7. Adopts a modified version of the Senate provision relating to charitable donations of food inventory. The modified provision extends the current-law deduction to S-corporations, partnerships and sole proprietors.
 8. Adopts a modified version of the Senate provision relating to charitable donations of books. The modified provision allows a tax deduction for educational books donated to public schools.
- These changes reflect a bipartisan agreement between the House and Senate. It is expected that the Senate will pass H.R. 3768, as amended by the House, pursuant to this agreement.